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4 BEFORE THE INSURANCE COMMISSIONER  
5 OF THE STATE OF WASHINGTON  
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7 In the Matter of

No. G02-45

8 THE APPLICATION REGARDING  
9 THE CONVERSION AND  
10 ACQUISITION OF CONTROL OF  
PREMERA BLUE CROSS AND  
ITS AFFILIATES

PRE-FILED RESPONSIVE  
TESTIMONY OF JONATHAN  
KOPLOVITZ

11 I, Jonathan Koplovitz, do hereby declare that the following facts are personally  
12 known to me and, if called upon to do so, I would testify to them.

13 1. The Blackstone Group ("Blackstone") has reviewed the pre-filed direct  
14 testimony of witnesses of the Premera Group ("Premera") and that of the Intervenors. I  
15 will address certain aspects of that testimony.

16 2. Pre-filed Direct Testimony of Kent Marquardt.

17 a. *Need for Capital, page 8.* Premera never indicated in any of its due  
18 diligence meetings with Blackstone that the Company lacked sufficient capital to  
19 support the Dimensions program or any other planned capital expenditure program. To  
20 the contrary, the Company had expressly indicated that it did not require an IPO to  
21 achieve its growth and operating plan. Premera is forecasting 20% operating income  
22 and 15% net income growth without any additional capital.  
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1                   b. *Automatic Extension of Window to Complete IPO, pages 22–23.*

2 Any extension after the initial twelve-month period to complete an IPO should be  
3 subject to the discretion of the Washington State Insurance Commissioner. Such a  
4 provision is consistent with previous demutualization/conversion transactions such as  
5 MetLife, WellChoice, Anthem, and Cobalt. Should there be pending litigation after  
6 twelve months, the Washington Commissioner can make the determination as to  
7 whether an extension is appropriate based upon the facts and circumstances at that time.  
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9                   c. *Change of Control Threshold, page 25.* Mr. Marquardt has indicated  
10 that Blackstone’s proposed modification should not be made as such a provision was  
11 not included in the WellChoice transaction. It is important to note that while many of  
12 the provisions of this conversion are comparable to WellChoice, there are certain  
13 provisions that are less favorable (from the Washington Foundation’s perspective) than  
14 those in WellChoice and others that are more favorable. While Blackstone reviewed  
15 WellChoice as a reference point (as well as other BCBS conversion transactions),  
16 Blackstone has analyzed this transaction on its own merits and in its entirety.  
17 Blackstone believes that the circumstances of this conversion are unique and as such  
18 warrant the proposed modifications that Blackstone has suggested to ensure that the  
19 Washington Foundation is sufficiently protected.  
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21                   d.       The Washington Foundation should be able to vote on significant  
22 transactions that may materially impact the value of its stock. A transaction that would  
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1 result in ownership dilution of 20% or more to Premera's shareholder base could have  
2 such an impact.

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4 e. ***Five percent of the Shares Held outside Voting Trust for Each***  
5 ***Foundation, page 26.*** In addition to our comments stated in the supplemental report on  
6 page 8, Blackstone believes that there could be a positive impact in value for shares  
7 held outside the trust. Moreover, since the Washington and Alaska Foundations would  
8 each individually satisfy the BCBS 5% ownership restriction as separate shareholders,  
9 each foundation should be allowed to hold 5% of their shares outside the trust.

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11 f. ***Premera's Ability to Reject a Foundation Nominee to the***  
12 ***Company's Board, page 28.*** Mr. Marquardt has indicated that Blackstone's proposed  
13 modification should not be made as such a provision was not included in the  
14 WellChoice transaction. Please refer to Blackstone's comments on page 2 (Change of  
15 Control Threshold) regarding the alignment of this transaction structure with the  
16 WellChoice transaction. In addition, Mr. Marquardt's statement that the consultants did  
17 not object to Premera's ability to reject all of the Washington Foundation's nominees  
18 for Premera's board is inaccurate. This concern was raised by Cantilo & Bennet and  
19 Blackstone during the discussions with Premera in late 2003/early 2004.

20  
21 g. ***Termination of Right to Designate Board Member, page 28.*** Mr.  
22 Marquardt has indicated that Blackstone's proposed modification should not be made  
23 as such a provision was not included in the WellChoice transaction. Please refer to  
24

1 Blackstone's comments on page 2 (Change of Control Threshold) regarding the  
2 alignment of this transaction structure with the WellChoice transaction. In addition,  
3 given the blackout periods, the Washington Foundation might still own as much as 50%  
4 of Premera's outstanding stock after five years. As such, it would be problematic for  
5 the Washington Foundation to arbitrarily lose its board seat after five years despite the  
6 fact that it still held a significant ownership interest in Premera.  
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8           h.       ***Requirement for Foundation to Own less than 80% of the***  
9 ***Company One Year After the IPO, page 29.*** The Washington Foundation may decide  
10 not to sell shares in the IPO (or to sell only a limited number of shares such that its  
11 ownership interest would still be greater than 80% after the IPO). Subsequently, the  
12 Washington Foundation may have limited opportunities to sell shares in the first year to  
13 reduce its ownership below 80% due to the initial six-month restriction period and the  
14 potential for short-term equity market dislocations. As a reference point, Premera  
15 believes that it needs a one-year window to complete its IPO due to the potential for  
16 short-term equity market dislocations. Consequently, this 80% restriction should be  
17 removed such that the Washington Foundation will have sufficient flexibility to  
18 monetize its interest in Premera in order not only to maximize the value of its holdings  
19 but also to be able to fund its charitable initiatives adequately and in a timely fashion.  
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22           i.       ***Termination of Voting Trust and Divestiture Agreement if***  
23 ***Premera were to Lose the BCBSA Mark, pages 28–29.*** The Voting Trust and  
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1 Divestiture Agreement in WellChoice provided that it would terminate if WellChoice  
2 were to lose the BCBSA Mark. The Premera agreement does not include this  
3 provision. WellChoice experienced a highly successful IPO and strong aftermarket  
4 stock performance, which would indicate that investors are comfortable with such a  
5 provision.  
6

7 j. Blackstone believes that this provision is required to protect the  
8 value of the Washington Foundation's investment were the Company to lose the  
9 BCBSA mark. The Washington Foundation has agreed to many of the terms and  
10 restrictions in the Voting Trust and Divestiture Agreement due to requirements  
11 indicated by the BCBSA. But for the need to accommodate the BCBSA requirements,  
12 the Washington Foundation would expect to have the same rights, protections and  
13 flexibility that a similar significant majority shareholder would otherwise possess.  
14

15 k. ***Ability to Continue a Company Registration Statement in which***  
16 ***Premera decides to Withdraw, page 31.*** Blackstone did not misinterpret the language  
17 in the Registration Rights Agreement allowing the Foundations to continue a  
18 registration in which the Company withdraws. Blackstone has proposed language that  
19 would strengthen this mechanism for the benefit of the Washington Foundation. Given  
20 its need to divest its stake rapidly, the Washington Foundation must preserve the ability  
21 to continue an offering that the Company aborts.  
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1                   1.     ***Ability to Influence and Control Pricing Decisions on***  
2     ***Foundation Demand Rights, page 32.*** While the Registration Rights Agreement  
3 provides that the Washington Foundation will have the right to appoint an underwriter  
4 as joint-book runner and stabilization agent in one of its demands, the Washington  
5 Foundation's board and/or pricing committee should also have the right to make  
6 determinations regarding pricing with respect to one of its demands regardless of  
7 whether the Company participates. As currently drafted, in any circumstance where  
8 Premera decides to sell shares in a Washington Foundation demand, the Company's  
9 board will make the pricing determination.  
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11                   m.     Given that such a registration would be a Washington Foundation  
12 demand and the Washington Foundation is subject to a divestiture schedule, it should  
13 have, at a minimum, some ability to influence any pricing determinations related to  
14 such a demand. In a Washington Foundation demand in which the Company  
15 participates, the Premera's board / pricing committee should consult with the  
16 Washington Foundation's board / pricing committee prior to making any final pricing  
17 determinations.  
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19                   n.     ***Definition of Independent Board Directors, pages 32-33.*** Given  
20 that Premera's independent directors will be voting the Foundation's shares on many  
21 matters, it is important that these directors are truly independent both from Premera's  
22 management team and its business activities.  
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1           3.       Pre-filed Direct Testimony of Gubby Barlow.

2                   a.       *Need for Capital, page 11.* Premera never indicated in any of its  
3 due diligence meetings with Blackstone that the Company lacked sufficient capital to  
4 support the Dimensions program or any other planned capital expenditure program. To  
5 the contrary, the Company had expressly indicated that it did not require an IPO to  
6 achieve its growth and operating plan. Premera is forecasting 20% operating income  
7 and 15% net income growth without any additional capital.  
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9                   b.       *Valuation of Premera, page 15.* Blackstone would clarify that the  
10 \$500–\$700 million valuation range for Premera was not based upon a formal valuation,  
11 but represents an illustrative, hypothetical valuation of the Company based upon market  
12 multiples for selected comparables as of October 2003. These multiples may not  
13 necessarily reflect the multiple at which Premera will trade after completion of its IPO.  
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15           4. Pre-filed Direct Testimony of John M. Steel.

16                   a.       *Termination of Voting Trust and Divestiture Agreement if*  
17 *Premera were to Lose the BCBSA Mark, page 24.* The Voting Trust and Divestiture  
18 Agreement in WellChoice provided that it would terminate if WellChoice were to lose  
19 the BCBSA Mark. The Premera agreement does not include this provision.  
20 WellChoice experienced a highly successful IPO and strong aftermarket stock  
21 performance, which would indicate that investors are comfortable with such a  
22 provision.  
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1           b.       Blackstone believes that this provision is required to protect the  
2 value of the Washington Foundation's investment were the Company to lose the  
3 BCBSA mark. The Washington Foundation has agreed to many of the terms and  
4 restrictions in the Voting Trust and Divestiture Agreement due to requirements  
5 indicated by the BCBSA. But for the need to accommodate the BCBSA requirements,  
6 the Washington Foundation would expect to have the same rights, protections and  
7 flexibility that a similar significant majority shareholder would otherwise possess.  
8

9           c.       ***Five percent of the Shares Held outside Voting Trust for Each***  
10 ***Foundation, page 27.*** In addition to our comments stated in the supplemental report on  
11 page 8, Blackstone believes that there could be a positive impact in value for shares  
12 held outside the trust. Moreover, since the Washington and Alaska Foundations would  
13 each individually satisfy the BCBS 5% ownership restriction as separate shareholders,  
14 each foundation should be allowed to hold 5% of their shares outside the trust.  
15

16           d.       ***Change of Control Threshold, page 29.*** The Washington  
17 Foundation should be able to vote on significant transactions that may materially  
18 impact the value of its stock. A transaction that would result in ownership dilution of  
19 20% or more to Premera's shareholder base could have such an impact.  
20

21           e.       In addition, Mr. Steel is inaccurate in suggesting that the Class B  
22 stock that would be held by the Washington Foundation provides protection for such a  
23 circumstance. In Premera's Articles of Incorporation, an affirmative vote of the Class  
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1 B shareholder (the Washington Foundation) is not required in circumstances where the  
2 Company is issuing shares related to mergers or stock option plans (among other  
3 things). Consequently, the Washington Foundation may not be able to properly protect  
4 the value of its holdings in Premera absent an ability to vote on such matters.  
5

6 f. ***Requirement for Foundation to Own less than 80% of the***  
7 ***Company One Year After the IPO, pages 29-30.*** The Washington Foundation may  
8 decide not to sell shares in the IPO (or to sell only a limited number of shares such that  
9 its ownership interest would still be greater than 80% after the IPO). Subsequently, the  
10 Washington Foundation may have limited opportunities to sell shares in the first year to  
11 reduce its ownership below 80% due to the initial six-month restriction period and the  
12 potential for short-term equity market dislocations. As a reference point, Premera  
13 believes that it needs a one-year window to complete its IPO due to the potential for  
14 short-term equity market dislocations. Consequently, this 80% restriction should be  
15 removed such that the Washington Foundation will have sufficient flexibility to  
16 monetize its interest in Premera in order not only to maximize the value of its holdings  
17 but also to be able to fund its charitable initiatives adequately and in a timely fashion.  
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20 g. ***Definition of Independent Board Directors, page 30.*** Given that  
21 Premera's independent directors will be voting the Foundation's shares on many  
22 matters, it is important that these directors are truly independent both from Premera's  
23 management team and its business activities.  
24

1           h.       ***Requirement to Sell Shares in Initial IPO, page 33.*** While it is  
2 likely that the Washington Foundation will sell some shares in the IPO, it needs the  
3 flexibility to make this determination at its discretion at a time much closer to the date  
4 of the IPO. The Washington Foundation may not wish to sell shares in the IPO due to  
5 (i) the Company's need for capital, (ii) the lack of short-term liquidity needs of the  
6 Washington Foundation and (iii) the IPO discount to which these shares would be  
7 subject. Any forced divestiture of shares may be contrary to the Washington  
8 Foundation's interest at that time and should be eliminated.

10           i.       ***Automatic Extension of Window to Complete IPO, pages 34-35.***  
11 Any extension after the initial twelve-month period to complete an IPO should be  
12 subject to the discretion of the Washington State Insurance Commissioner. Such a  
13 provision is consistent with previous demutualization/conversion transactions such as  
14 MetLife, WellChoice, Anthem, and Cobalt. Should there be pending litigation after  
15 twelve months, the Washington Commissioner can make the determination as to  
16 whether an extension is appropriate based upon the facts and circumstances at that time.

18           j.       ***Washington Foundation's Right to Designate a Representative to***  
19 ***Premiera's Board, pages 35-36.*** Large investors typically are entitled to some board  
20 representation. Given the Washington Foundation's expected ownership level (83%-  
21 89%), it should have the right to designate its own board representative.

23           5.       Pre-filed Direct Testimony of Brian Kinhead.  
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1                   a.       ***Comparability of the Transaction to Previous Transactions, page***

2       7. If Premera made the proposed modifications detailed in Blackstone's supplemental  
3       report, Blackstone believes that Premera's plan taken as a whole would generally be in-  
4       line with the plans from previous BCBS conversions. Thus, the concept of investors  
5       ascribing a lower valuation for a plan that contained out of market provisions would not  
6       apply.  
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8                   b.       ***Impact on Value of Proposed Modifications to the Transaction,***

9       ***page 8.*** Many of the proposed modifications in Blackstone's report are not intended to  
10       enhance the value of Premera's stock to outside investors, but are in fact intended to  
11       protect the value of the Washington Foundation's stake. In addition, Blackstone does  
12       not believe that the proposed modifications would adversely affect the value of Premera  
13       to a public investor, assuming that it retained its BCBSA Mark.  
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15               6.       Pre-filed Direct Testimony of Richard A. Furniss.  
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17                   a.       ***Initial Restriction on the Grant of Options, pages 13-14.***

18       Blackstone does not agree with the characterization that most conversions have not had  
19       a 12-month restriction period after the IPO for the granting of options. Several recent  
20       conversion and demutualization transactions have had a similar restriction, including  
21       WellChoice, Prudential, Phoenix, MetLife, John Hancock and MONY.  
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1 I declare under penalty of perjury under the laws of the State of Washington  
2 that the foregoing is true and correct to the best of my knowledge and belief.

3 Dated April 14, 2004 at New York, New York.

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6   
7 JONATHAN KOPLOVITZ  
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